

CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK

STAFF REPORT

ISSUE: Staff requests approval of two resolutions in relation to prior sales of certain tobacco assets by the California Infrastructure and Economic Bank (I-Bank), as the State's agent for sale, to the Golden State Tobacco Securitization Corporation. The law pertaining to those sales has been amended, and the two resolutions presented to the Board are for the purpose of addressing this change in law.

BACKGROUND INFORMATION:

The State of California is party to a Master Settlement Agreement entered into on November 23, 1998, among the attorneys general of 46 states, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands and the Original Participating Manufacturers (as defined therein) pursuant to which the State is entitled to receive certain payments.

Article 7 (commencing with Section 63049) of the I-Bank Act (Article 7) authorizes the I-Bank, for, and on behalf of, the State, and solely as its agent, to sell all or any portion of the tobacco assets (as defined in Article 7) received pursuant to that Master Settlement Agreement, or any residual interests therein. Article 7 authorizes this sale to a special purpose trust established as a not-for-profit corporation, and permits the I-Bank to enter into sales agreements for that purpose with the special purpose trust.

Pursuant to this authorization, the State has sold tobacco assets and residual interests to the Golden State Tobacco Securitization Corporation (Golden State) pursuant to a variety of sales agreements. In order to purchase these tobacco assets and residual interests, Golden State has issued bonds secured by the purchased tobacco assets and residual interests.

A brief history of Golden States' bonds, the tobacco asset sale agreements related to those bonds, and the Board's related approvals follows:

- Golden State issued bonds designated "Tobacco Settlement Asset-Backed Bonds, Series 2003A" (Series 2003A Bonds) and purchased related tobacco assets from the I-Bank pursuant to a Purchase and Sale Agreement dated as of January 1, 2003 (2003A Sale Agreement). The 2003A Sale Agreement was approved by the I-Bank Board in its Resolution 02-52.
- Golden State issued its "Enhanced Tobacco Settlement Asset-Backed Bonds, Series 2003B" (Series 2003B Bonds) and purchased related tobacco assets from the I-Bank pursuant to a Purchase and Sale Agreement dated as of September 1, 2003 (2003B Sale Agreement). The Series 2003B Bonds are additionally secured by a "General Fund-Backing" provision, which requires the Governor to include an annual request in his budget proposal for an appropriation sufficient to meet the debt service on the bonds not

otherwise met through the revenue stream generated by the tobacco assets. The 2003B Sale Agreement was approved by the I-Bank Board in Resolution 03-05.

- Golden State subsequently issued its refunding bonds designated “Enhanced Tobacco Settlement Asset-Backed Bonds, Series 2005A” (Series 2005 Bonds) to refund the Series 2003B Bonds, and in connection with the Series 2005 Bonds, the I-Bank and Golden State entered into a First Supplemental Purchase and Sale Agreement, dated as of July 1, 2005, supplementing the 2003B Sale Agreement (2005 First Supplemental Sale Agreement). The 2005 First Supplemental Sale Agreement was approved by the I-Bank Board in Resolution 05-16.
- Golden State subsequently issued its bonds designated “Tobacco Settlement Asset-Backed Bonds, Series 2007” (Series 2007 Bonds) in part to refund the Series 2003A Bonds and in part to purchase certain residual tobacco assets, and in order to sell the residual tobacco assets, the I-Bank entered into a Purchase and Sale Agreement with Golden State, dated as of February 1, 2007 (2007 Sale Agreement). The 2007 Sale Agreement was approved by the I-Bank Board in Resolution 07-03.

Pursuant to Section 63049.4 within Article 7, in each purchase and sale agreement, directly or by incorporation, the State has pledged and agreed with the holders of the related Golden State bonds that the State will not amend the Master Settlement Agreement, a memorandum of understanding and documents related thereto between the State and various local governments of the State (defined in Article 7 as the “Memorandum of Understanding”, and referred to herein as the Tobacco MOU) or the California Escrow Agreement (as defined in Article 7) in any way that would alter, limit or impair the rights and remedies of those bondholders or the security for their bonds, while the bonds remain unpaid.

A change in law (Stats. 2009, Chapter 28, effective August 6, 2009; Senate Bill 53) has amended Section 63049.4. The law now permits amendments to the Master Settlement Agreement, the Tobacco MOU and the California Escrow Agreement that do not “materially adversely” alter, limit or impair bondholders’ rights to receive tobacco assets sold to Golden State or in any way “materially” impair the rights and remedies of bondholders or the security for their bonds, while the bonds remain unpaid.

RESOLUTION 10-08:

In response to Senate Bill 53, amendments to the following sections of the following sale agreements have been prepared, are on file with the Secretary of the Board, and are presented to this meeting:

- Section 4.01 of the 2003A Sale Agreement.
- Section 4.01 of the 2003B Sale Agreement and Section 2.01 of the 2005 First Supplemental Sale Agreement.
- Section 4.01 of the 2007 Sale Agreement.

By their respective terms, these sale agreements can be amended by agreement of the I-Bank and Golden State with the consent of the trustee for the Series 2005 Bonds and the Series 2007 Bonds, as applicable, and upon receipt of a confirmation from each rating agency then rating the bonds that the unenhanced rating then assigned to the applicable series of Golden State's bonds will not be adversely affected as a result of the proposed amendments to the Master Settlement Agreement. At the time the Series 2005 Bonds and the Series 2007 Bonds were issued, Standard and Poor's, Moody's Investors Service and Fitch Ratings, Inc. rated each series of Golden State's bonds.

Currently the unenhanced Series 2005 Bonds are rated BBB+ by Standard & Poor's, Baa2 by Moody's and BBB- by Fitch. The unenhanced Series 2007 Bonds are rated BBB by Standard & Poor's, Baa3 by Moody's and BBB+ by Fitch. None of the 2003A or 2003B are legally outstanding, and the fully refunded Series 2003A Bonds and Series 2000B Bonds are rated AAA by both Standard & Poor's and Fitch.

The process of obtaining rating confirmations from each of the rating agencies currently rating the bonds is underway. It is anticipated that the bond trustee will consent to the amendments upon receipt of the ratings confirmation. The resolution before the Board conditions the authorization of execution of amendments to the 2003A Sale Agreement, the 2003B Sale Agreement and related 2005 First Supplemental Sale Agreement, and the 2007 Sale Agreement, subject to the bond trustee's receipt of the necessary rating confirmations, and the trustee's consent to the amendments.

The Board of Directors of Golden State met on February 16, 2010, and approved these proposed sale agreement amendments.

RESOLUTION 10-09:

In response SB 53, I-Bank staff proposed that the I-Bank, Golden State and the Attorney General establish a mechanism for determining between the State as represented by the I-Bank and the Attorney General, and Golden State, whether any proposed amendment to the Master Settlement Agreement, the Tobacco MOU or the California Escrow Agreement would have a material effect on the holders of Golden State's bonds.

I-Bank staff have worked with staff of Golden State and Deputy Attorneys General to establish this mechanism and document it in a memorandum of understanding between the parties. The mechanism established in the memorandum of understanding includes:

- Notice by the Attorney General to the I-Bank and Golden State of any proposed amendments to the tobacco settlement documents that could alter, limit or impair the rights to receive tobacco assets or impair the rights and remedies of Golden State's bondholders or the security for their bonds.
- Provision by the Attorney General of fiscal and economic analyses, forecast and other information that describe or predict the effect of any such amendment.

- Opportunity by any party to object to any such proposed amendment and to require a rating confirmation prior to the Attorney General entering into any such amendment.

The proposed form of the Memorandum of Understanding is now on file with the Secretary of the Board and is presented to this meeting. The Board of Directors of Golden State met on February 16, 2010, and approved this form of the Memorandum of Understanding.

RECOMMENDATIONS:

RESOLUTION 10-08:

I-Bank staff recommend that the Board adopt Resolution 10-08, authorizing the execution and delivery of the 2003 Amendatory Sale Agreement, the 2005 Amendatory Sale Agreement and the 2007 Amendatory Sale Agreement, each by and between the I-Bank as the State's agent for sale of tobacco assets and Golden State, subject to the receipt of required ratings confirmations and the approval of the trustee for the Series 2005 Bonds and the Series 2007 Bonds.

RESOLUTION 10-09:

I-Bank staff recommend that the Board adopt Resolution 10-09, authorizing the execution and delivery of the Memorandum of Understanding by and between the I-Bank, for, and on behalf of, the State, and solely as its agent for sale of the tobacco assets, Golden State and the Attorney General.